



COUNCILMEMBER DONNA FRYE
City of San Diego
Sixth District

MEMORANDUM

DATE: April 23, 2007

TO: Greg Levin, Deputy Comptroller

FROM: Councilmember Donna Frye *Donna Frye*

SUBJECT: Independent Auditor's Report on Internal Control in
Accordance with Government Auditing Standards (KPMG Internal Control
Report)

I received your five-page, April 20, 2007 Memorandum regarding the March 12, 2007 KPMG *Internal Control Report* (which you refer to as the Yellow Book Report). Thank you for that. This responds to some of the items you raised.

On March 16, 2007, the Mayor held a press conference announcing a "clean" audit opinion from KPMG for the City of San Diego's 2003 Comprehensive Annual Financial Report (CAFR). The two-page KPMG audit opinion was dated March 12, 2007 and titled *Independent Auditor's Report*. Obviously, this was great news, particularly in light of the many financial concerns that plague the City.

The March 12, 2007, KPMG *Independent Auditor's Report* stated that, "In accordance with Government Auditing Standards, we have also issued our report dated March 12, 2007 on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters." And, that this *Internal Control Report* "is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit."

I made several earlier requests for the March 12, 2007 *Internal Control Report*, including a March 19, 2007, request to KPMG and an April 18, 2007 request to you at the Budget Committee meeting. Later that day you sent it to me by e-mail with a transmittal correspondence that said, "Here you go." (See attached #1.) Attached to your e-mail was the KPMG *Internal Control Report*, dated March 12, 2007.

Neither your e-mail nor the March 12, 2007 KPMG *Internal Control Report* (sent as an attachment with your e-mail) contained any language, notations or marks indicating that it was an incomplete report or a draft report. You also did not indicate that it was not a

public document. (For future reference, please note that my office considers a document to be “public” unless the document is otherwise noted.)

I found the contents of this report compelling as it addressed serious and important financial deficiencies which I would have expected to see distributed with the 2003 CAFR and noted in the audit letter, neither of which happened. I circulated that report to colleagues for discussion as the receipt and filing of the 2003 CAFR was docketed for Monday April 23rd.

In your April 20, 2007, memorandum you question the propriety of circulating that report, suggesting that what you had sent me was a draft, not ready for public review or discussion.

In response to the not surprising public discussion on this report, and its lack of public viewing contemporaneous with the “clean” audit opinion, on April 22, 2007, in the letters to the editor section of *The San Diego Union –Tribune* Mayor Sanders wrote, “Traditionally, audit firms will render an opinion on a municipality’s internal controls at the same time that they bless the organization’s financial statements. That didn’t happen for the city’s fiscal year 2003 audit because the internal controls report was still being drafted when the audit opinion was released.” (See attached #2.)

Just to be clear on my part, the March 12, 2007 KPMG *Independent Auditor’s Report*, **stated that KPMG had issued their Internal Control Report on March 12, 2007** - the same date as they issued their *Independent Auditor’s Report*. The audit report actually says so, and I would have no reason to suspect that our auditors would be publicly issuing a “clean” audit opinion while still “drafting” an “internal controls” report (dated the same day as the audit) that was obviously supposed to be read contemporaneously with the audit letter.

Mayor Sanders April 22 letter to the editor says that KPMG did not issue the *Internal Control Report* on March 12, 2007- the same date as KPMG issued their *Independent Auditor’s Report*, and the actual date of the *Internal Control Report*. This suggests that this report, when it was finally issued, was in fact “back dated,” a practice I find alarming, particularly in light of the circumstances of this City, this audit, and the obvious interests of citizens and public markets.

KPMG should change their March 12, 2007 *Independent Auditor’s Report* to reflect the actual issuance date of the *Internal Controls Report*, and explain why they stated in their *Independent Auditor’s Report* that they issued their *Internal Controls Report* on March 12, 2007, when according to the Mayor that is clearly not true.

Beyond that, I note that the “final” version of the March 12, 2007 *Independent Auditor’s Report* does not reflect any changes whatsoever from the “draft” version you suggest was sent to me for my review on April 20th, the circulation of which caused such concern.

CC: Honorable City Council
Honorable Mayor Sanders
City Attorney, Michael Aguirre
Independent Budget Analyst, Andrea Tevlin
Steve DeVetter, KPMG

DF/ks

Donna Frye - Yellow Book Report

From: Greg Levin
To: Frye, Donna; Hadley, Steven; Smith, Kevin
Date: 4/18/2007 1:15 PM
Subject: Yellow Book Report
CC: Goldstone, Jay

Here you go.

ATTACHMENT #1

Letters to the editor San Diego Union-Tribune

April 22, 2007

Mayor finds nothing 'usual' in fiscal problems

The word “usually” caught my eye in “KPMG list of findings has more bad news” (Our Region, April 20) on a 2003 internal controls report written about the city by KPMG. There's nothing usual about the way in which the city has managed its money or the financial systems that help account for taxpayers funds – and those are the problems that we are now working to correct.

Traditionally, audit firms will render an opinion on a municipality's internal controls at the same time that they bless the organization's financial statements. That didn't happen for the city's fiscal year 2003 audit because the internal controls report was still being drafted when the audit opinion was released. That's understandable. The city's financial systems were so bad that it had to restate 66 items worth about \$2 billion as part of the 2003 audit. While all of the messes are well chronicled in this report, it's fair to say that there's nothing new. All of the same findings already appeared in the Kroll report issued last summer.

There is little doubt that the systems I inherited were a mess or that they cost our city dearly. I was elected to fix them and that's exactly what we have begun to do. Last August I said that I would implement 100 percent of Kroll's remedial recommendations. To date, we have successfully addressed half of its recommendations. In fact, on Tuesday the City Council will vote on the new computer system that I have proposed. Much more remains to be done. We will continue making steady progress so that the kinds of problems that created our city's financial crisis can never happen again.

JERRY SANDERS
Mayor of San Diego

ATTACHMENT #2